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THE CONSTITUTIONALITY OF A FEDERAL CEILING ON STATE SEVERANCE TAXES

I. INTRODUCTION

The energy crisis of the 1970's confronted industrial countries with the harsh reality that most energy resources are finite in supply, and are located in third world countries which will not hesitate to seek optimal compensation for the depletion of their resources.[1] In the United States, spiraling energy prices and long gas lines have led to political and economic turmoil which has since beleagured the nation. While heated debate raged among politicians, consumers, oil lobbyists, and a myriad of other interest groups, there seemed to be a consensus that the energy exporting countries were being unfair,[2] that the energy crisis was the cause of most economic problems,[3] and consequently that there must be increased utilization of domestic energy resources.[4] The focus on domestic resources has, however, revealed issues which prompt closer examination of some of the assumptions regarding the energy crisis. Nationally, perhaps the most controversial of these issues is the state severance tax.[5]

States impose severance taxes on the extraction or processing of natural resources located within their boundaries.[6] Most severance taxes are levied as a percentage of the extracted resource's value. Historically, severance taxes have been relatively low—one or two percent of the resource's value.[7] With the increased demand for domestic resources,

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1. *See generally* D. DAVIS, ENERGY POLITICS (1978).

2. *See generally How much to Pay the OPEC Piper?*, TIME, Nov. 8, 1976, at 92; *No Tears for OPEC*, NEWSWEEK, Mar. 1, 1976, at 69.

3. *See, e.g.*, *How OPEC's High Prices Strangle World Growth*, BUS. WEEK, Dec. 20, 1976, at 44.

4. *See, e.g.*, Power Plant and Industrial Fuel Use Act of 1978, 42 U.S.C. § 8301 (b)3 (1980); Energy Policy and Conservation Act of 1975, 42 U.S.C. § 6201(6) (1976).

5. *See generally* Note, *The Increasing Conflict between State Coal Severance Taxation and Federal Energy Policy*, 57 TEX. L. REV. 675 (1979).

6. *See, e.g.*, N.M. STAT. ANN. §§ 7-26-1 to -11 (1975 Supp.).

7. *See* Link, *Political Constraints and North Dakota's Coal Severance Tax*, 31 NAT'L TAX J. 263 (1978).

however, the resource-rich states[8] started to raise their severance taxes. For example, Colorado and North Dakota imposed a new coal severance tax,[9] New Mexico increased its uranium tax,[10] and Montana increased its coal severance tax to 30%—the highest in the nation.[11]

The wave of the new or higher severance taxes has been viewed by the rest of the nation as OPEC-like price haggling.[12] Complaining bitterly about the economic impact of severance taxes,[13] the resource-dependent states claim these taxes are in direct conflict with our national energy policy.[14]

The resource-producing states contend that added revenues are needed to meet the ever-increasing costs of more intensive mining. These costs include not only societal costs of boomtowns and environmental costs of mining,[15] but also increased revenues for the development of alternative economic bases.[16] In short, these states seek economically diverse and viable communities that will prosper after their resource wealth has been depleted.[17]

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8. In general, resource-rich states are states that export significant amounts of non-renewable natural resources. Most of these states are located in the West, e.g., Montana, Colorado, Wyoming, New Mexico, and Texas. Altogether some 33 states impose severance taxes on various resources. *See Court Holds States Free to Set Resource Taxes*, N.Y. Times, July 3, 1981, at B12, col. 1 (late city ed.).

9. N.D. CENT. CODE §§ 57-61-01 to -10 (1981); COLO. REV. STAT. § 39-29-106 (1980). Colorado also imposes severance taxes on oil, gas and oil shale. *See* COLO. REV. STAT. §§ 39-29-101 to -114.

10. N.M. STAT. ANN. § 7-26-7 (1982 Supp.).

11. MONT. CODE ANN. §§ 15-35-101 to -111 (1981).

12. *See Boom in Strip Mining: Windfall for Montana*, Washington Post, May 22, 1977, at 1, col. 1.

13. " 'The people down here are angry' says Mayor Carole McClellan of Austin, Texas, who complains that Montana's severance tax on coal will cost her city $100 million in higher utility bills over the next 19 years. 'We feel like we are being had.' " *Montana's 30% Severance Tax on Coal Fuels Producer-Buyer Confrontation*, Wall St. J., March 26, 1980, at 19, col. 1.

14. " 'It's confiscatory, unfair, unconstitutional,' says Leon Cohan, Detroit Edison's general counsel. 'And it's in direct conflict with our national energy policy of using more coal instead of oil.' " *Id.*

15. According to Senator Baucus of Montana, the purpose of Montana's coal severance tax is "straight forward: to enable coal mining towns to provide schools, hospitals, roads, sewers, police and fire protection—basic services so desperately needed when local populations mushroom with new mining." *Taxation of Natural Resources*, VITAL SPEECHES OF THE DAY, Mar. 15, 1980, at 333.

16. "Our severance tax represents a way to develop our resources in a rational and responsible manner. It prohibits reckless development while encouraging sound planning for the future." *Id.*

17. "We must make sure that our future is not part of a massive boom-bust cycle." *Id.* at 332. As a Montana Rancher opined, "People are attacking us for doing

While the two sides have been engaged in name calling—"Rocky Mountain OPEC," echoing back, "neocolonial exploitation,"—the real confrontation has been taking place in the courts and in Congress. The resolution of this confrontation involves difficult decisions regarding the tenuous balance between state and federal power. The U.S. Supreme Court, in its recent decision, *Commonwealth Edison v. Montana*,[18] seems to have temporarily shifted the decision-making burden to Congress. Congress, on the other hand, has been busy debating a bill that would place a 12½% ceiling on severance taxes for coal which is mined from federal lands.[19] This comment discusses the constitutionality of such a bill and the plausibility of some alternatives.

II. Historical Background

The framers of the United States Constitution sought to resolve economic problems between the states by delegating to Congress the power "to regulate Commerce . . . among the several states . . . ."[20] The affirmative power to regulate commerce, however, has become the federal government's single most powerful regulatory tool—determining the ratio of federal-state power.[21] The balance of power has been flexible and responsive to "the various *crises* of human affairs."[22]

During the depression of the 1930's, the balance of power shifted dramatically in favor of the federal government. In a series of decisions during the so-called Constitutional Revolution of 1937, the Supreme Court allowed Congress to restore and unify the national economy using the commerce power.[23] Congress was given plenary power to protect and advance interstate commerce.[24] Congress, therefore, was authorized to regulate or prohibit any intra-state activity which substantially affected interstate commerce,[25] regardless of its

something we think is responsible . . . . Coal-based economies always go to hell. We're trying to avoid the boom-bust cycle." *Supra* note 13.

18. 453 U.S. 609 (1981).
19. H.R. 1313, 97th Cong., 1st. Sess. (1981); S.178, 97th Cong., 1st Sess. (1981).
20. U.S. Const. art. I, § 8, cl. 3.
21. *See generally* L. Tribe, American Constitutional Law § 6-2 (1978).
22. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 415 (1819).
23. *See generally* R. McCloskey, The American Supreme Court 180-87 (1960).
24. NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 36-37 (1936).
25. United States v. Darby, 312 U.S. 100 (1941).

triviality.[26]

In the absence of congressional action, the courts restricted states' interference with the national economy, utilizing the negative implication[27] of the commerce clause, commonly referred to as the dormant commerce clause.[28] The history of the dormant commerce clause may be summarized as an attempt by the courts to cope with the increasingly sophisticated regulations of commercial relationships.[29] The modern dormant commerce clause test was set forth in *Pike v. Bruce Church, Inc.*:[30]

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to putative local benefits. [citation omitted]. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the

26. *See, e.g.*, Wickard v. Filburn, 317 U.S. 111 (1942) (Congress authorized to regulate a farmer growing wheat for his own consumption on the theory that if the farmer did not grow it himself, he would have had to purchase the wheat in interstate commerce).

27. Originally, in the absence of congressional action, the Court defined the scope of the commerce clause more narrowly. If a state regulation was held valid under the dormant commerce clause, this did not imply Congress could not prohibit that regulation under the commerce clause. *See* Douglas v. Seacoast Products, Inc., 431 U.S. 265, 282 n.17 (1977). Lately, however, the Court has been hinting strongly that the scope of commerce is the same under the commerce clause as it is under its negative implication in the dormant commerce clause. *See* Hughes v. Oklahoma, 441 U.S. 322, 326 n.2 (1979). Commentators have generally agreed with this trend. *See* Comment, *Constitutional Limitations on State Severance Taxes*, 20 NAT. RESOURCES J. 887, 893-94 (1980).

28. *See generally* G. GUNTHER, CONSTITUTIONAL LAW 256 (1980); L. TRIBE, *supra* note 21, at §§ 5-4 to -8.

29. Historically, when commerce was in its fledgling stages, the inquiry under the dormant commerce clause focused on the purpose of the state regulation, distinguishing between the exercise of commerce and police powers. *See* Gibbons v. Ogden, 20 U.S. (9 Wheat.) 1 (1924). As the economy grew, the commerce-police distinction became clouded because many regulations could be labeled as the exercise of either power. In dealing with state regulation of its ports, the inquiry turned to the effect of the regulation, distinguishing between the national and local subjects of such regulation. *See* Cooley v. Board of Wardens, 53 U.S. (12 How.) 298 (1851). The expansion of the nation's railroad system presented another hybrid situation in which the national-local distinction was of little help. In striking down legislation regulating train lengths, the Court finally adopted a balancing test which considered the state interest and the burden on interstate commerce. *See* Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945).

30. 397 U.S. 137 (1970).

> nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.[31]

Pike's four prong balancing test considers both the state's interests and the burden on interstate commerce and therefore is an effective test regardless of the complexity of the regulations.

III. State Taxation Cases

A. *Pre*-Montana

Traditionally, the Supreme Court has applied the dormant commerce clause analysis where state involvement with the national economy took the form of taxation. During the 1920's the Court decided three important resource taxation cases, known as the *Heisler* Trilogy.[32] In each case, the Court held that the act of severance, like manufacturing, preceded the flow of commerce and was therefore a local activity immune to commerce clause scrutiny.[33] The *Heisler* decisions were prompted by the Court's fear that expansion of the commerce power to include products destined for exportation would nationalize all industries.[34]

A corollary to the "local activity" doctrine was that the states could tax "local incidents" of interstate business, such as the generation of power.[35] The "local incidents" rule, however, was an exception to the general rule that the privilege of doing interstate business could not be subject to state taxation.[36] In application, the privilege doctrine was handicapped by its mechanical approach which made the validity of a tax dependent on its label.[37]

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31. *Id.* at 142.

32. Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922).

33. In Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923), the Court held that "mining is not interstate commerce, but, like manufacturing, is a local business subject to local regulation and taxation." *Id.* at 178.

34. Heisler v. Thomas Colliery Co., 260 U.S. at 259-60.

35. *See, e.g.*, Utah Power & Light Co. v. Pfost, 286 U.S. 165 (1932).

36. *See, e.g.*, Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1925); Western Union Tel. Co. v. Kansas *ex rel.* Coleman, 216 U.S. 1 (1910).

37. *Compare* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) (state taxation of exclusively interstate operations of foreign corporation upheld) *with* Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951) (state tax-

In 1977, the Court finally abandoned the privilege doctrine and in accordance with its approach under *Pike,* adopted a more flexible test. In *Complete Auto Transit Inc. v. Brady,*[38] the Court upheld a Mississippi privilege tax, emphasizing that interstate commerce must pay its own way "even though it increases the cost of doing business."[39] In moving "toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology,"[40] the Court held that a state tax is *not* invalid if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce and is fairly related to the services provided by the State."[41] The four prongs of *Complete Auto* may be generally classified under two categories: 1) the state's *power* to tax; and 2) the *amount* of the tax.

1. *Power to Tax*

The substantial nexus and fair apportionment prongs of *Complete Auto* relate to the state's power to tax. The genesis of these provisions lies in due process considerations. The substantial nexus prong, for example, requires minimum contacts between the state and the activity taxed, in order to assure the existence of jurisdiction over the taxpayer.[42] If the taxpayer is within a state's jurisdiction, taxing him results in a local impact which serves as a political restraint on the state legislature.[43] Excessive taxes that adversely impact a taxpayer's business also harm the state economy. The political-check ingredient of *Complete Auto* is important because it represents the Court's traditional reliance on the political process as a limitation on the legislative powers, at least in the area of commerce.[44]

Complete Auto's second requirement of a fairly appor-

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ation on income of foreign corporation which was engaged exclusively in interstate trucking held invalid).

38. 430 U.S. 274 (1977).

39. *Id.* at 288 (quoting Colonial Pipeline Co. v. Triangle, 421 U.S. 100, 108 (1974), quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

40. 430 U.S. at 281.

41. *Id.* at 279.

42. *See* National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967); American Oil Co. v. Neill, 380 U.S. 451 (1965).

43. *See* McGoldrick v. Berwind-White Co., 309 U.S. 33, 45 n.2 (1939).

44. *See, e.g.,* Champion v. Ames, 188 U.S. 321 (1903).

tioned tax embodies the same fairness considerations of due process. This provision is designed to prevent multiple taxation of interstate commerce by requiring that the tax rate be proportional to the in-state business of the taxpayer.[45]

The non-discrimination third prong of *Complete Auto* represents the same fairness concerns of due process, but it is also closely linked to the commerce clause, the very purpose of which "was to create an area of free trade among the several States."[46] In practice, non-discrimination eliminates taxes that directly benefit local business and thereby prevents balkanization of the states.[47] The Court, in considering this prong, examined the state's total tax structure including the "various tax credits and exclusions."[48]

2. *The Amount of Tax*

The final requirement of *Complete Auto* is that the tax must be fairly related to the sources provided by the state. Until recently, this factor was thought to limit the amount of the tax. The *Montana*[49] decision, however, seems to have discarded this factor altogether. To understand *Montana's* impact, a discussion of prior case law is necessary.

A limitation on the amount of tax logically stems from the extent of the contacts between the state and the taxed activity. Prior to *Montana*, the Court seemed to be leaning towards this reasoning. As explained in *Wisconsin v. J.C. Penney Co.*,[50] the question is whether the state has provided any services for which it can ask payment.[51] An inquiry under the fair-relationship factor, therefore, "would include not only direct government services such as police and fire protection, but the less obvious support of a trained workforce which helps mold a civilized society."[52] Conversely, the state could exact "from interstate commerce its fair share of the cost of

45. *See* Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938).

46. McLeod v. J.E. Dilworth Co. 322 U.S. 327, 330 (1944).

47. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 462 (1959); Halliburton Oil Well Co. v. Reily, 373 U.S. 64, 74 (1963); Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 329 (1977).

48. Maryland v. Louisiana, 451 U.S. 725, 756 (1981).

49. 453 U.S. 609 (1981).

50. 311 U.S. 435 (1940).

51. *Id.* at 444.

52. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979).

state government."[53]

In application, however, the Court appeared unwilling to calculate the dollar value of these state services. For example, in upholding the state of Washington's 1% tax on stevedoring activities, the Court quickly determined that the fourth prong was satisfied by simply stating: nothing in the record suggested that the tax was not fairly related to state provided services.[54] The failure to expand the fair relationship requirement prompted some commentators to develop formulas for measuring cost-based tax rates.[55] It was against this background that the controversy over Montana's 30% coal tax arose.

B. Montana *Case*

The states of Montana and Wyoming hold some 40% of the coal reserves in the United States and 68% of the low-sulfur coal.[56] The environmental pollution restrictions enacted in the 1970's greatly enhanced the value of and demand for the low-sulfur western coal. Montana and Wyoming exported 80% of their coal.[57] Since 1921, Montana has imposed a nominal tax on coal mined on state and federal lands. In 1975 Montana increased its coal severance tax rate on the surface mining of coal with a heating quality of 7000 Btu per pound or greater to 30% of the contract price.[58] This caused a sharp increase in tax revenues which has continued due to the high demand for low-sulfur coal.[59] In fact, in 1976 the Montana Constitution was amended to create a trust fund for 50% of the severance tax revenues.[60]

In 1978, several coal producers and utility companies sued the state of Montana, seeking an injunction against fur-

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53. Department of Revenue of Washington v. Association of Washington Stevedoring Co., 435 U.S. 734, 748 (1978).

54. *Id.* at 751.

55. *See* Comment, *An Outline for Development of Cost-Based State Severance Taxes*, 20 NAT. RESOURCES J. 913 (1980).

56. H.R. REP. No. 1527, 96th Cong., 2d Sess. 3 (1980) [hereinafter cited as H.R. REPORT].

57. *Id.*

58. MONT. CODE ANN. § 15-35-103 (1981). Wyoming has raised its coal severance tax to 17½% from its prior level of 2%. WYO. STAT. § 39-6-303 (1981).

59. The following dollar amounts constituted Montana's coal severance tax revenues: $42 million in 1979 and approximately $80 million in 1980. *Supra* note 13.

60. MONT. CONST. art. IX, § 5.

ther coal taxes. The plaintiffs' primary claim was that the tax was invalid under the commerce clause. The lower court upheld the tax and the Montana Supreme Court affirmed.[61] In *Commonwealth Edison Co. v. Montana,*[62] a divided Court[63] held that Montana's tax did not violate the commerce clause because it "comport[ed] with the requirements of the *Complete Auto Transit* test."[64] As expected,[65] the Court rejected *Heisler's* "local activity" test and emphasized instead the substantiality of the "practical effects" of severance taxes on interstate commerce.[66] The *Montana* decision appears to have significantly modified *Complete Auto* and its progeny, raising interesting questions concerning the treatment of severance taxes under the dormant commerce clause.

The Court briefly dealt with *Complete Auto's* first and second prongs. It was clear that the taxpayer's only nexus with the state was the taxed activity, namely, severance of coal in Montana. Also, there was no possibility of multiple taxation because the severance occurred only in Montana.[67]

The Court held furthermore, that Montana's tax was nondiscriminatory because it used the same rate regardless of the coal's destination. The appellants unsuccessfully argued that because of its large exports, Montana, in effect, had shifted the tax burden onto the consuming states, thus discriminating against commerce. Noting that a similar claim was rejected in *Heisler,* the Court stressed that to declare a tax discriminatory because of a state's position of monopoly would require an unwarranted departure from the commerce clause's basic purpose of creating an arena of free trade among the states.[68] Implicit in the concept of free trade is that one state has no right of access to the resources of another state at reasonable prices.[69] The Court's strong advocacy of free trade, however,

61. — Mont. —, 615 P.2d 847, *aff'd,* 453 U.S. 609 (1980).

62. 453 U.S. 609 (1981).

63. Chief Justice Burger, Justices Marshall, Brennan, Stewart and Rehnquist made up the majority. Justice White concurred and Justices Blackmun, Powell and Stevens dissented.

64. 453 U.S. at 629.

65. Commentators had predicted the rejection of *Heisler's* analysis. *See, e.g.,* Browde & DuMars, *State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier,* 60 OR. L. REV. 7, 40 (1981).

66. 453 U.S. at 614-17.

67. *Id.* at 617.

68. *Id.* at 618-19.

69. "[W]e are not convinced that the Commerce Clause, of its own force, gives

was undermined when it pointed out that "formidable evidentiary difficulties" prevent the application of antitrust laws.[70]

After concluding that the tax was non-discriminatory, the Court proceeded to reject the appellants' argument that the fourth prong required that the amount of tax be fairly related to the cost of the state services furnished. The Court, following the Montana Supreme Court's analysis,[71] pointed out that the question was not the *amount* of tax, but the *power* to tax. Once there was sufficient nexus with the state, the taxpayer was liable not only for the cost of his activities but for the government's general support. In return, the only benefit to the taxpayer "[was] that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purpose."[72] To reemphasize that the "amount" of tax was not the issue, the Court insisted that "the words 'amount' and 'value' were not even used" in its decisions[73] indicating the Court's sensitivity to the confusion over its treatment of the fourth prong.

Analytically, the fourth prong is divided into two parts. First, "the interstate business must have a substantial nexus with the state . . . ."[74] But, this requirement is identical to the first prong. Although the Court admitted that the two tests were "closely connected," it stopped short of explaining their differences, if any existed.[75] If the nexus test is met, the second part requires that the "*measure* of the tax must be reasonably related to the extent of the contract . . . ."[76] This part is a subcategory of *Complete Auto's* second prong which requires the tax to be fairly apportioned to the taxpayer's intra-state activities.

To illustrate this relationship, consider a taxpayer who owns a nationwide business which grosses $10 million annu-

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the residents of one State the right to control in this fashion the terms of resource development and depletion in a sister state." *Id.* at 619.

70. *Id.* n.8.

71. *See* — Mont. —, —, 615 P.2d 847, 855-56 (1980).

72. 453 U.S. at 623 (quoting Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 521-23 (1937)).

73. 453 U.S. at 625 n.15.

74. *Id.* at 626.

75. The Court cited the same precedent for the first prong and the first part of the fourth prong; *see* National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967).

76. 453 U.S. at 626.

ally, $2 million of which is from business done in state X. Under the fair apportionment prong, State X may impose a tax only on that portion of the taxpayer's business that generates the $2 million. Under the second part of the fourth prong, however, the tax rate must be reasonably related to the taxpayer's extent of contact with State X, i.e., the $2 million worth of business, so that " 'the incidence of the tax *as well as its measure* [must be] tied to the earning which the State . . . has made possible . . . .' "[77] The simplest way to satisfy this test is to tax that percentage of the taxpayer's income which is derived from the state. In fact, most severance taxes, including Montana's coal tax, are measured as a percentage of the value of the mineral taken.

The *Montana* analysis signaled a green light for severance taxes. Most resource-rich states are scarcely populated and export the bulk of their resources. These states, therefore, can easily impose a uniform tax using a rate equivalent to a percentage of the value of the minerals severed[78] thereby satisfying the dormant commerce clause.

The question at the heart of the controversy, however, has remained unanswered. All interested parties want to know the limits of a severance tax rate. There are two very general limitations. First, the tax must be a general revenue tax "imposed for the general support of the government."[79] Consequently, taxes like "user taxes" imposed for the use of state facilities do not qualify and must be a general measure of the taxpayer's benefit. But problems may be avoided by labeling the tax as general revenue because the Court will defer to such a legislative characterization.[80] Moreover, general revenue has been viewed broadly to include "tax revenues for use by the future generation."[81] The second general limitation mandates that a percentage tax may not be "so arbitrary as to [constitute], in substance and effect, the direct exertion of a different and forbidden power, as, for example the confisca-

77. *Id.* (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 446 (1940)).

78. *See supra* text accompanying notes 6-10.

79. 453 U.S. at 621 (quoting Commonwealth Edison Co., v. Montana, — Mont. —, —, 615 P.2d 847, 856 (1980)).

80. The Court actually noted it would defer to the characterization used by the Montana Supreme Court. *Id.* The Montana Supreme Court, however, deferred to the legislature. — Mont. at —, 615 P.2d at 856. Thus, it is reasonable to assume the U.S. Supreme Court would also defer to the state legislatures.

81. 453 U.S. at 621 n.11.

tion of property."[82] A tax therefore is arguably invalid if it forces the taxpayer out of business.

The Court has chosen not to interfere with the severance taxes. The reason for this course of action is twofold. The Court has always been concerned with the impracticalities of deciding a proper tax rate.[83] As the Montana Supreme Court bluntly stated: "[I]t is impossible for any court to foot up the dollar cost of the government benefits [received by a taxpayer.]"[84] Apart from judicial difficulties in setting tax rates, such tasks have been appropriately handled by the legislatures. The political process is better equipped to absorb inputs from different interests, which results in equitable solutions.[85]

The second reason for the Court's refusal to pass judgment on a tax rate is that it "would involve abandonment of the most fundamental principle of government—that it exists primarily to provide for the common good."[86] In other words, the government could not function if it had to tax individuals according to the value of the benefits they receive.[87]

IV. Congressional Action

With the courts out of the picture, the opponents of severance taxes have turned to Congress as their "last resort."[88] The prospect of other states raising their taxes in light of the *Montana* decision has been an added worry.[89] In fact, while the Supreme Court was considering Montana's coal tax, Montana was considering taxing platinum right "back into the

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82. *Id.* at 627 n.17 (quoting Magnano Co. v. Hamilton, 292 U.S. 40 (1934)). *See also* United States v. Kahriger, 345 U.S. 22 (1953). *See generally* L. Tribe, *supra* note 21, at § 5-9.

83. As the Court noted in Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 455 (1979), the commerce clause "does not call for mathematical exactness nor for the rigid application of a particular formula . . . ." (quoting Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292, 325 (1943)).

84. — Mont. at —, 615 P.2d at 855.

85. *See generally* Bickel, *Forward: The Passive Virtues*, 75 Harv. L. Rev. 40 (1963); Wechsler, *Toward Neutral Principles of Constitutional Law*, 73 Harv. L. Rev. 10 (1959).

86. 453 U.S. at 623 (quoting Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 521-23 (1937)).

87. 453 U.S. at 627 n.16.

88. *A Drive to Cap Severance Taxes*, Bus. Week, July 27, 1981, at 94.

89. *See Court Holds States Free to Set Resource Taxes*, N.Y. Times, July 3, 1981, at B12, col. 1.

ground."[90]

In 1980, a bill was introduced in the 96th Congress purporting to place a ceiling of 12½% on state severance taxes.[91] Reported favorably by the House Subcommittee on Energy and Power,[92] the bill died in the House Committee on Interior and Insular Affairs. In 1981, during the 97th Congress, an identical bill was introduced, supported by more than forty congressmen.[93] While the congressmen of the resource-rich states prepared for an "ambush,"[94] the White House appeared to be a much needed friend. In fact, support from the White House was strong enough to convince a reluctant Justice White to concur in the *Montana* decision.[95] Thus, even though the chances of the bill becoming law are at best mediocre, the possibility of such a congressional action poses significant legal issues which the Supreme Court will have to settle.

A. *Commerce Clause*

The proposed bill, H.R. 1313 would amend the Powerplant and Industrial Fuel Act of 1978 to limit severance taxes to coal which is destined for shipment in interstate commerce for use by any major fuel burning installation.[96] By limiting severance taxes to 12½%, the bill purports to alleviate the national energy crisis, reduce dependence on oil imports, en-

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90. BUS. WEEK, March 2, 1981 at 25.

91. H.R. 6625, 96th Cong., 2d Sess. (1980); H.R. 6654, 96th Cong., 2d Sess. (1980); H.R. 7163, 96th Cong., 2d Sess. (1980).

92. *See* H.R. REPORT, *supra* note 56.

93. H.R. 1313, 97th Cong., 1st Sess. (1981). The companion bill in the Senate was S. 178, 97th Cong., 1st Sess. (1981).

94. *Taxation of Natural Resources, supra* note 15.

95. "[W]e are counseled by the Executive Branch . . . not to overturn the Montana tax . . . ." 453 U.S. at 637 (White, J. concurring).

96. H.R. 1313 reads in relevant part:

> [T]he Congress finds that, in order to alleviate the national energy emergency, reduce national dependence on petroleum imports, encourage the highest and best use of domestic petroleum and natural gas, and enhance interstate commerce by promoting increased reliance on our national reserves of coal for the generation of electricity and power, it is necessary to remove excessive burdens on production of coal used in powerplants and major fuel-burning installations . . . . [A]ny coal which is destined for shipment in interstate commerce for use in any powerplant or major fuel-burning installation, the sum of all severance taxes or fees . . . levied . . . by a State . . . shall not exceed a total of 12½ percent of the value of such coal . . . .

courage use of domestic oil and gas, and enhance interstate commerce.

The proponents and opponents of H.R. 1313 agree that the only source of constitutional power for enacting such a bill lies in the commerce clause. The question then becomes whether Congress can limit state severance taxes under the commerce power. As noted earlier, Congress may regulate or prohibit any activity which substantially affects interstate commerce.[97] The Court must defer to a congressional finding that there is a substantial effect on commerce if there is any rational basis for such a finding.[98] Furthermore, the means chosen by Congress must be reasonably related to the ends sought by the congressional action.[99] Regarding the reasonableness of the means, the Court also defers to congressional judgment.

In light of Congress' plenary power to regulate commerce and the Court's passive role, it would appear unlikely that the Court would invalidate a limiting bill such as H.R. 1313. Upon close examination of the facts pertaining to the possible effects of severance taxes on interstate commerce, however, a finding of "any" rational basis becomes very difficult. Moreover, some recent commerce clause decisions indicate a non-deferential approach by a minority of the Court. Finally, a federal limitation on state taxation is unprecedented, if not unconstitutional, which is another reason for the Court not to set a dangerous precedent in the climate of New Federalism.

1. *Rational Basis Test*

In the recent decision of *Hodel v. Virginia Surface Mining & Reclamation Ass'n,*[100] the U.S. Supreme Court upheld the constitutionality of the Surface Mining Control and Reclamation Act of 1977. It held that Congress had a "rational basis for concluding surface coal mining had substantial ef-

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97. In a few recent cases, the Court appears to have dropped the requirement of a "substantial" effect on interstate commerce. The cases lack consistency, however. As a suspicious Justice Rehnquist conceded, "[i]t may be that I read too much into the Court's choice of language." Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264, 312 (1981).

98. *Id. See also* Heart of Atlanta Motel v. United States, 379 U.S. 241 (1964); Katzenbach v. McClung, 379 U.S. 294 (1964).

99. Hodel v. Indiana, 452 U.S. 314, 324 (1981).

100. 452 U.S. 264 (1981).

fects on interstate commerce."[101] In his concurring opinion, Justice Rehnquist appeared to be planting the seeds for a closer review by the future Court in suggesting that commerce power may be restricted in two ways.[102]

First, regarding the requirement that the regulated activities impact on interstate commerce, Justice Rehnquist pointed out that "some nexus" or a "trivial impact" is insufficient. Instead, a *substantial* effect on interstate commerce was required. He further suggested a non-deferential review of congressional findings, noting that "simply because Congress may conclude that a particular activity substantially affects interstate commerce does not necessarily make it so. Congress' findings must be supported by a 'rational basis' and are reviewable by the Courts."[103] Justice Rehnquist would nevertheless defer to Congress' choice of means in effectuating the regulation.[104]

In application, the requirement of *a* rational basis, as opposed to *any* rational basis, would involve an exhaustive analysis of "Congress' articulated justifications for the exercise of its power under the commerce clause . . . ."[105] As an example, Justice Rehnquist cited the majority's approach in *Hodel*. There, however, the Court merely recited Congress' express findings and the legislative history. Perhaps the fact that the legislature considered the challenged statute for six years, mitigated the "exhaustive" analysis Justice Rehnquist suggested. Nevertheless, Justice Rehnquist, the Chief Justice and perhaps Justice O'Connor would certainly review congressional findings carefully looking for *a* rational basis, with the possibility of disagreeing with Congress' conclusions.[106]

Review of the legislative material compiled in H.R. 1313,[107] suggests the minority would strike down the bill and

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101. *Id.* at 280.

102. *Id.* at 305. In a separate concurring opinion the Chief Justice agreed with Justice Rehnquist's analysis.

103. *Id.* at 311. Note that under the majority's approach, the Court would probe the legislative history or record for *any* rational basis; on the other hand, Justice Rehnquist requires a congressional finding of an explicit rational basis.

104. *Id.* at 311.

105. *Id.*

106. *Cf., e.g.,* Perez v. United States, 402 U.S. 146 (1971) (Stewart, J., dissenting) (Court held Congress can regulate loan sharking because it adversely affects interstate commerce).

107. *See Proposed Amendments to the Powerplant and Industrial Fuel Use Act of 1978: Hearings on H.R. 6625, H.R. 6654 and H.R. 7163 Before the Subcomm.*

it is highly likely the majority would concur. The subcommittee report[108] summarized congressional findings and contained several possible rational bases. It should be noted at the outset, however, that nowhere in the report is there a finding that severance taxes above 12½% substantially affect interstate commerce.

The subcommittee on Energy and Power found that increased coal severance tax rates resulted in a reduction in coal production.[109] Coal is usually purchased pursuant to long-term contracts that require substantial investments in transportation and processing equipment, rendering a change of supplier impractical.[110] Coal purchasers, therefore, are frequently unable to shop around for lower prices. The subcommittee reasoned that lack of market mobility together with high severance taxes discouraged investments in coal, thereby reducing production. A decrease in domestic energy supply should increase the demand for foreign oil, resulting in a higher national trade deficit.

This conclusion, however, has no rational basis. Higher severance taxes have not, in fact, discouraged investment or reduced coal production. Coal buyers have always been aware of the possibility of increasing severance taxes; coal contracts routinely provide for the increases in severance taxes to be borne by consumers.[111] Moreover, Montana, for example, has experienced rapid growth in its coal production since the early 1970's.[112] This rate of growth remained unaffected by the sharp increase of severance taxes in 1975. Although a decline in production occurred during the 1977-1978 period, it was caused by a nationwide coal strike which depressed coal production. There is no evidence of lack of investment interest in Montana's coal. Since the imposition of the 30% tax, at least two major utility companies have signed 25 year contracts with Montana coal producers.[113] The demand for western coal

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on Energy and Power of the House Comm. on Interstate and Foreign Commerce, 96th Cong. 2d Sess. (1980) [hereinafter cited as *H.R. Hearings*].

108. *See* H.R. REPORT, *supra* note 56.

109. *Id.* at 4.

110. *See* Holmes, *Negotiating, Drafting, and Enforcing Coal Supply Contracts,* 9 NAT. RESOURCES LAW. 353 (1976).

111. *See* H.R. REPORT, *supra* note 56, at 4.

112. *Id.* at 21.

113. The two companies were Detroit Edison and Houston Lighting & Power Co. *See H.R. Hearings, supra* note 107 (statement of W. Christiansen).

continues despite severance taxes because it is the cheapest coal in the nation.[114] In short, an increase in coal production and continued investment in coal contradict the argument that high severance taxes frustrate the national energy policy and create higher trade deficits.

Secondly, the subcommittee found that higher severance taxes increase consumers' utility bills. This finding is also totally unsupported by the facts. Even though the increase in severance taxes is passed on to the consumers, the impact is minimal. According to some estimates severance taxes add only half of 1% to utility bills as compared to a 5% increase for sales taxes.[115]

In the long run, an increase in utility bills is even beneficial to interstate commerce. It is no secret that energy consumption in the United States has been needlessly wasteful.[116] Numerous studies have shown that increased energy costs encouraged conservation.[117] Not only does conservation minimize the waste of the nation's coal reserves, but it benefits commerce by ensuring a longer period of coal usage throughout the nation. Conservation, however, may only harm utility companies with long term contracts; they have to wait longer to recover their investment. It is not surprising that utility companies were among the plaintiffs in *Montana*. It would indeed be irrational to conclude that severance taxes affect commerce where only a handful of utility companies are affected.

Finally, the subcommittee suggested that excessive severance taxes result in budget surpluses in some states, at the expense of other states. Retaliation based on regionalism, therefore, may occur which could conceivably interfere with interstate commerce.[118] The argument of regionalism is not only unfounded, but the implementation of regionalism is illegal. One of the primary reasons for drafting the commerce clause was the prevention of economic warfare among the

114. *Id.*

115. *See H.R. Hearings, supra* note 107 (statements of D. Ostendorf & W. Christiansen).

116. *See* D. DAVIS, ENERGY POLITICS 1 (1974); Leapman, *America: The World's Greediest Guzzler*, N.Y. Times, June 17, 1979, at 14F, col. 3 (late city ed.).

117. *See* Hershey, *Winning the War on Energy*, N.Y. Times, Oct. 11, 1981, at 1, sec. 3, col. 1 (late city ed.); *Energy Price Effects*, N.Y. Times, Jan. 3, 1982, at 16F, col.3 (late city ed.).

118. *See* H.R. REPORT, *supra* note 56, at 6.

states.[119] The Union has not been beset by retaliation over the numerous severance taxes already in existence. Imposition of a ceiling on severance taxes of western states would most certainly create far more regionalism.[120] Such federal action would be resented by the western states and would set a dangerous precedent.

It is evident that none of the subcommittee's conclusions regarding reduction in coal production, significant increase of utility bills and regionalism, are supported by a rational basis. In fact, the evidence is to the contrary. Severance taxes, when viewed in light of the nation's energy needs and other factors, have a trivial impact upon interstate commerce, and may actually benefit the economy.

2. *"In" Commerce Limitation*

Justice Rehnquist's second suggestion in his *Hodel* concurrence, with regard to restricting the commerce clause, was an interesting new version of an old idea. During the 1920's while the "substantial impact" test was in its infancy,[121] the Court was experimenting with the "current of commerce" test in trying to expand the reach of the commerce power. Justice Holmes first used the current of commerce test in *Swift & Co. v. United States.*[122] He emphasized that some local activities were subject to the commerce power because they could be viewed as "in" commerce or as an integral part of the "current of commerce." Applying this rationale, the Court held that under the Sherman Act Congress had the power to stop price fixing by meat dealers whose cattle were "sent for sale from a place in one State, with the expectation that they [would] end their transit, after purchase in another . . . ."[123] The current of commerce theory was used several more times and was informally abandoned after the birth of the substantial effect test.[124]

In light of its traditional use to expand the reach of the commerce clause, the question arose as to how the "current of

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119. *See* Browde & DuMars, *supra* note 65, at 12.

120. *See H.R. Hearings, supra* note 107, at 134-64 (statement of Governer Herschler of Wyoming).

121. The origin of the "substantial effect" test is in the Shreveport Rate case. Houston E. & W. Texas R.R. v. United States, 234 U.S. 342 (1941).

122. 196 U.S. 375 (1905).

123. *Id.* at 398.

124. *See, e.g.,* Stafford v. Wallace, 258 U.S. 495 (1922).

commerce" theory could be used to limit the clause. The answer lies in its negative implication, as phrased by Justice Rehnquist that, "[s]ome activities may be so private or local in nature that they simply may not be *in* commerce."[125] Because of the limited application of the current of commerce rationale, the scope of its negative implication is undetermined.

One point seems to be clear, however; there is no necessary correlation between the "substantial effect" and "current of commerce" theories.[126] The two approaches yield the same results when applied to certain facts, but yield different results when applied to other situations. In other words, an activity may not be *in* commerce but it may have a substantial effect *on* commerce.[127] For example, consider the negative implication of *Swift:* Cattle that are not destined for shipment in interstate commerce are not *in* commerce, but because of disease or limited pasturage such cattle may substantially affect the cattle destined for interstate commerce and thus affect commerce.[128]

In applying the "in" commerce limit to severance taxes, it may be argued that the minerals go through two stages before entering commerce. First, they are extracted from the land and become the personal property of the producer. Secondly, the producer sells them to the purchasers. Severance taxes are imposed on the extraction of minerals in advance of any entry of the minerals into commerce.[129]

The possible inconsistencies with other aspects of commerce clause analysis may prove the "in" commerce limit useless. A potential litigant, however, should be aware of the fact that at least three Justices favor such a limit and perhaps a

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125. Hodel v. Virginia, Surface Mining & Reclamation Ass'n, 452 U.S. 264, 310 (1981).

126. *Compare* Maryland v. Wirtz, 392 U.S. 183 (1968) *with* National League of Cities v. Usery, 426 U.S. 833 (1976). *Usery* overruled *Wirtz's* holding but not its analysis.

127. *See, e.g.,* United States v. Rock Royal Co-Operative, Inc., 307 U.S. 533 (1939).

128. *Cf., The Beef Research and Information Act of 1976,* 7 U.S.C. § 2901-2918 (1976). Section 2901 states in part: "Cattle, beef and beef products move in interstate and foreign commerce and those which do not move in such channels of commerce directly burden or affect interstate commerce . . . ."

129. *See* — Mont. —, —, 615 P.2d, 847, 857. (1980).

few more may be convinced after further developments.

3. *Unprecedented Action*

In considering the constitutionality of H.R. 1313, the Court should keep in mind that limiting state taxes in such a fashion is "totally without precedence"[130] and may in fact be unconstitutional. Judging from the dicta in *Montana,* however, the Court seemed to welcome congressional action. Emphasizing that the legislatures should set tax rates, the Court noted that in the context of federalism, "the determination is to be made by state legislatures in the first instance and, if necessary, by the Congress, when particular state taxes are thought to be contrary to federal interests."[131] Justice White agreed in his concurring opinion, noting that "[t]he constitutional authority and the machinery . . . are available to Congress . . . ."[132] Justice Blackmun, dissenting, not only agreed that Congress had the power to restrict state taxes, but opined that if Congress did nothing, "strong policy and institutional considerations suggest that it was appropriate that the Court consider this issue."[133]

A review of the case law paints a different picture. In general, Congress has the power to *prohibit* state taxation that substantially affects interstate commerce. The power to prohibit has been exercised over a variety of state taxes or fees. For example, in 1871, Congress prohibited state pilot charges on steamships with federally licensed pilots. The Court upheld this prohibition in *Spraigne v. Thompson.*[134] In 1975, the Federal Securities Acts were amended to prohibit state taxation of certain stock share transfers made through the facilities of a registered agent located in the state.[135] In *Boston Stock Exchange v. State Tax Commission,*[136] the Court *sub silentio* upheld this amendment.[137]

It may be argued that the power to prohibit implies the power to limit. Indeed, prohibition is limitation taken to its extreme. Thus, the opponents of severance taxes would argue

130. *See H.R. Hearings, supra* note 107, at 51 (statement of M. Greely).
131. 453 U.S. at 628.
132. *Id.* at 638.
133. *Id.* at 652 n.19.
134. 118 U.S. 90 (1886).
135. 15 U.S.C. § 78b(d) (1976) (amending § 28 of the Securities Act of 1934).
136. 429 U.S. 318 (1977).
137. *Id.* at 321 n.4.

that if Congress has the power to prohibit severance taxes, it certainly can limit them.[138] The fallacy in this reasoning, however, becomes apparent upon a close examination of the case law, particularly the recent decision of *Arizona Public Services Co. v. Snead.*[139]

A. *The Right To Tax*

The Supreme Court in *Arizona* invalidated New Mexico's electricity tax. New Mexico imposed a severance tax on the generation of electricity within the state.[140] The tax, roughly 2% of the retail value, applied to each net kilowatt hour of generated electricity.[141] In 1976, Congress enacted the Tax Reform Act which prohibits states from taxing the generation of electricity in a manner which discriminates against out-of-state consumers.[142]

Relying on the Tax Reform Act, the owners of several power plants sued New Mexico, alleging discrimination. Although the tax rate was uniform, discrimination resulted because the state allowed the electricity tax to be credited against the gross receipts tax if the electricity was consumed within the state. New Mexico argued that its electricity tax was beyond the reach of the commerce clause. In rejecting New Mexico's argument, the U.S. Supreme Court found that Congress had plenary power to prohibit state taxation of electricity generation. After examining the legislative history and record, the Court concluded that "Congress had a rational basis for finding that New Mexico's tax interfered with interstate commerce and selected a reasonable method to eliminate that interference."[143]

The Tax Reform Act of 1976 prohibited, not limited, discriminatory severance taxes. Congress could have achieved equality in tax treatment by imposing a ceiling on the tax rate for out-of-state consumers so as to compensate them for the tax credits available for electricity consumed in-state. Instead Congress chose a flexible standard which restricted New Mexico's method or "means" of taxation and not the amount or

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138. *See* H.R. REPORT, *supra* note 56, at 11.

139. 441 U.S. 141 (1979).

140. N.M. STAT. ANN. §§ 72-34-1 to 6 (1975 Supp.).

141. Utah Power & Light Co. v. Pfost, 286 U.S. 165 (1932).

142. Tax Reform Act of 1976, Pub. L. No. 94-455 § 2121(a), 90 Stat. 1914 (codified at 15 U.S.C. § 391 (1976)).

143. 441 U.S. at 150.

the "ends" of its tax objective. The Court seemed to rely implicitly on this distinction noting that:

> The generation of electricity in the Four Corners region undoubtedly also generates environmental and other problems for New Mexico. There is no indication that Congress intended to prevent the State from taxing the generation of electricity to pay for solutions to these problems . . . . Congress required only that New Mexico, if it chooses to tax the generation of electricity for consumption . . . tax it equally . . . .[144]

The distinction between congressional restriction over the *means* employed for taxation by the state as opposed to restrictions over the *ends* or the amount of the revenue, is also implicit in the *Montana* case. The Court relied in part on two cases for the proposition that Congress may regulate state taxes if such taxes are contrary to federal interests. In *Moorman Manufacturing Co. v. Bain,*[145] the Court noted that the commerce clause "would amply justify the enactment of legislation requiring all States to adhere to *uniform rules* for the division of income."[146] More specifically, in *Mobil Oil Corp. v. Commissioner of Texas,*[147] the Court indicated that "Congress in the future may see fit to enact legislation requiring *a uniform method* for state taxation of foreign dividends."[148] One can conclude, therefore, that under the commerce clause, Congress may only be able to regulate the *method* of state taxation.

This conclusion does not necessarily negate Congress' power to regulate the amount of revenue sought to be raised by a state. Of course, control over the taxation method may indirectly affect the amount of revenue eventually raised. But state's are allowed the freedom of choosing an appropriate means of raising the same revenues. There is, however, a more fundamental reason other than lack of freedom. At the heart of the distinction between "means" and "ends" lies one of the most important constitutional principles: the source of federal power is limited to the delegated powers in the Federal Constitution whereas there is no such limitation on the states'

144. *Id.* at 150-51.
145. 437 U.S. 267 (1978).
146. *Id.* at 280 (emphasis added).
147. 445 U.S. 425 (1980).
148. *Id.* at 449 (emphasis added).

source of power.[149] Neither Congress nor the states may exercise their power in a manner prohibited by any provisions of the U.S. Constitution.[150] Moreover, pursuant to the Constitution, Congress may choose to restrict the states' exercise of power but Congress may not restrict the source of that power.[151] In other words, Congress may only exert control over the "means" of state action and not over the "ends" sought by such action.

The same analysis applies to taxation. Raising revenues through taxation falls under the states' power or right to tax. The manner or means of taxation is an exercise of the right or power to tax. The right to tax "exists apart from constitutions"[152] whereas its exercise is subject to legislative control. These principles were first enunciated in the landmark case *McCulloch v. Maryland.*[153] As Justice Marshall noted:

> That the power of taxation is one of vital importance; that it is retained by the states; that it is not abridged by the grant of similar power to the government of the Union; that it is to be concurrently exercised by the two governments—are truths which have never been denied. But such is the paramount character of the constitution, that its capacity to withdraw any *subject* from the action of even this power, is admitted.[154]

Justice Marshall proceeded to offer an example of an expressly "withdrawn subject" of states' power to tax, namely, the constitutional prohibition of imposing duties on imports or exports. In establishing the full scope of the supremacy clause, Justice Marshall indicated that a state may be restrained "from such other *exercise* of [the taxing] power, as is in its nature incompatible with, and repugnant to, the constitutional laws of the Union."[155]

Once the differences between the power to tax (ends) and exercise of that power (means) becomes clear, the difference

149. L. TRIBE, *supra* note 28, at § 5-2.

150. *Id.*

151. *Id.*

152. 71 AM. JUR. 2d *State and Local Taxation* § 71 (1973) (citing Miles v. Department of Treasury, 209 Ind. 172, 199 N.E. 372, *appeal dismissed,* 206 U.S. 640 (1936); People *ex rel.* Hatch v. Reardon, 184 N.Y. 431, 77 N.E. 970, *aff'd,* 204 U.S. 152 (1906)).

153. 17 U.S. (4 Wheat.) 316 (1819).

154. *Id.* at 425 (emphasis added).

155. *Id.* (emphasis added).

between the power to limit and the power to prohibit also becomes apparent. As in the Tax Reform Act of 1976, Congress may prohibit a manner of state taxation upon a finding of interference with commerce. A percentage limitation on a tax, however, is not a restriction on the manner of taxation; rather, it is a restriction on the states' power to tax. In other words, imposition of a 12½% ceiling on severance taxes is the functional equivalent of degradation of 87.5% of the power to tax.[156] Such a restriction on the power to tax is unconstitutional.

b. *The Problem of "Sterile" Law*

The unconstitutionality of imposing a percentage limitation on state severance tax rates, creates the possibility of congressional restriction on the manner of severance taxation. In fact, such an attempt was made in 1979 by Congressman Pickle's bill. This proposed legislation prohibited state severance taxation of a resource extracted from federal lands, unless such taxes were fairly related to the services provided by states in connection with the taxed activities.[157] The Pickle bill raised the issue of whether such a restriction accomplishes "more than the Commerce Clause of the Constitution would accomplish of its own force,"[158] i.e., whether the legislation is sterile. Of course, the issue of sterile legislation has become worthy of consideration in light of recent trends indicating the Court is defining the scope of commerce under the dormant commerce clause in the same manner as the scope of commerce under the Congress' affirmative power to regulate commerce.[159]

In *Snead,* New Mexico correctly argued that its electricity tax was compatible with the dormant commerce clause;[160] if the electricity tax was considered within the state's total tax structure, then there was no discrimination against out-of-state purchases.[161] In rejecting this argument, the Court held

156. *See supra* text accompanying note 82.

157. H.R. 5294, 96th Cong., 1st Sess. (1980).

158. Arizona Public Service Co. v. Snead, 441 U.S. 141, 151. (1979).

159. *See supra* note 27.

160. Utah Power & Light Co. v. Pfast, 286 U.S. 165 (1932), held that a tax on generation of electricity did not violate the commerce clause because generation of electricity was a local activity. Arizona Public Service Co. v. Snead, 441 U.S. 141, however, has *sub silentio* overruled *Utah Power & Light.*

161. New Mexico argued that the electricity sold within the state was subject to a 4% gross receipts tax and a 2% electrical energy tax credit. But, the two taxes

that if Congress explicitly finds that a state tax provision burdens commerce, then the Court's review of such a finding will be restricted to the statute itself.[162] In other words, Congress may go beyond the dormant commerce clause standards if it makes such an intention known. Moreover, there is a presumption of congressional intent to surpass the dormant commerce clause, i.e., a presumption of non-sterility.[163]

The Pickle bill would have overcome the problem of sterility by addressing "the relationship between the revenues generated by a tax and costs incurred on account of the taxed activity . . . ."[164] Therefore, the broad interpretation of "fairly related" in *Montana* may be avoided. Of course, as far as the Court is concerned, the Pickle bill would present the same problem of making complex factual inquiries, which the Court avoided in *Montana*. Even though the task would be tedious, there is nevertheless, an important difference between setting dollar limits pursuant to a dormant commerce clause challenge and interpreting the law. The difference is that it is politically healthier for the Court to make controversial decisions pursuant to a congressional directive. The Court could freely settle the controversy without political overtones. Justice Blackmun's dissent in *Montana* sheds light on the majority's political considerations. Dismayed by the Court's rationale of complex evidentiary issues, Justice Blackmun hinted that such problems have not stopped the Court from considering other taxes like user fees.[165]

In interpreting the "fairly related" clause of the Pickle bill, the Court should enlist some guidelines developed by the commentators in connection with the application of *Complete Auto's* fourth prong prior to the *Montana* decision.[166] There are essentially three types of costs to state governments created by severance of natural resources. First, there are direct costs which include construction of public facilities, e.g., roads

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would off-set each other, resulting in a 2% tax (assuming that gross receipts are roughly equal to retail value). So at worst, the electricity consumed outside the state was taxed at the same rate as that consumed within the state. 441 U.S. at 149.

162. *Id.* at 150.

163. *Id.* at 151-52. (Rehnquist, J., concurring).

164. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 627 (1981).

165. *Id.* at 638 n.13. Also, Justice Blackmun noted that "there is no basis for the conclusion that the issues, presented would be more difficult than those routinely dealt with in complex civil litigation." *Id.* n.17.

166. *See* Note, *supra* note 55.

and schools, and remedying the immediate environmental problems associated with mining. Second, there are the costs of proper management of long-term environmental damage, including cost of land reclamation and air quality restoration. Finally, the most controversial cost category concerns the eventual downfall of boomtown economies upon depletion of the mineral wealth. The states must be able to transform their economic bases so as to not only offer a more stable future for their residents but to also benefit the nation as a whole by providing new industries.[167]

As mentioned earlier, a common theme in the case law on the commerce clause is that interstate business may constitutionally be made to "pay its way."[168] The question facing Congress and the Court is for which of the above cost categories is interstate business responsible. A responsible decision would include all categories not only for the states' welfare but also for the welfare of the nation.[169]

B. *State Autonomy*

Assuming that a federal limitation on state severance taxes is upheld as a valid exercise of the commerce power, such federal action may be unconstitutional on the basis of impermissible intrusion into state sovereignty. In *National League of Cities v. Usery*,[170] the Court struck down a congressional regulation of commerce which sought to extend federal minimum wage and maximum hour laws to state employees.[171] Relying on principles of dual sovereignty and the tenth

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> Further, Wyoming does not have the industrial base or manufacturing industries necessary to diversify its economic base when the natural resources are mined out. One only has to look at the Appalachian States to see what happens when the coal industry leaves. Wyoming citizens do not want to see that type of legacy. And if you recall, substantial federal investment has poured into Appalachia since 1960 to correct the grim social and economic landscape that remained when the Coal Companies left.

H.R. Hearings, *supra* note 107 (statement of Governor Herschler).

168. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 284 (1977).

169. *See* Horton, *The Energy Policy Game—The Odds on Independence*, 9 NAT. RESOURCES LAW. 49 (1976).

170. 426 U.S. 833 (1976).

171. Act of April 8, 1974, Pub. L. No. 93-259, § 6, 88 Stat. 58 (1974) (codified at 29 U.S.C. § 203 (1970)).

amendment, the Court set out a commerce clause test:[172] legislation was invalid if it 1) regulated the "States as States;" 2) addressed matters that are indisputably "attributes of state sovereignty;" 3) directly impaired the States' ability, "to structure integral operation in areas of traditional functions;" and 4) did not represent an overriding "federal interest."[173]

The application of *National League of Cities*, however, has remained limited; further, uncertainty persists regarding its meaning and scope. On the one hand, *National League of Cities* has been interpreted as the grandeur of the Burger Court's committment to states' rights. On the other hand, *National League of Cities* has been compared to the Warren Court's concern with individual rights and a constitutional guarantee of basic governmental services.[174] Although a discussion of the possible theories of *National League of Cities* is beyond the scope of this paper, the application of the *National League of Cities* test to its facts offers a basis for an analysis of the validity of a federal ceiling on state taxes.

A limiting bill such as H.R. 1313, speaks directly to the states, requiring them to levy severance taxes below 12½%. The only discretion left to the states would be either to increase their revenues by other taxes, or to reduce the quality of their services. Federal regulation of states as states, which leaves them the choice of increased taxes or reduction of essential services, was one of *National League of Cities'* major concerns.[175]

Moreover, limiting state taxes would significantly alter the states' ability to provide integral services in areas of "traditional" functions like "fire prevention, police protection, sanitation, public health, and parks and recreation."[176] The increasing demand for domestic energy has resulted in a noticeable population increase in the western states. For exam-

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172. *See* Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264, 278 (1981). Whether or not *National League of Cities* applies to other state powers is an open question. *But see* Pennhurst State School v. Halderman, 451 U.S. 1, 17 n.13 (1981).

173. Although the fourth factor was mentioned by the majority, it was stressed in Justice Blackmun's concurring opinion. *See also* 452 U.S. at 278 n.29.

174. *See* Tribe, *Unraveling National League of Cities: The New Federalism and Affirmative Rights to Essential Government Services*, 90 HARV. L. REV. 1065 (1977).

175. 426 U.S. at 847-48.

176. *Id.* at 851.

ple, an increase of 1000% in Wyoming's coal production during the 1970's was matched by a population explosion of 43% and a corresponding demand on government services.[177] These services, however, are limited to basic necessities such as road construction, education, police, sewers, and hospitals[178]—a far cry from the needs of a "great society." The proponents of severance taxes are only concerned with meeting the "basic" needs of their cities and states and are in fact devout conservatives advocating cutting federal taxes.[179] A decrease in severance taxes would, therefore, substantially impair such integral services which the states have traditionally offered their citizens.[180]

Perhaps one of the most undisputed attributes of state sovereignty is the power to tax. As early as *McCulloch v. Maryland,* the power to tax has been recognized as a power inherent in sovereignty. The same conclusion may be inferred from *National League of Cities.* After all, if the power to determine wages of government employees is an attribute of sovereignty, so too is the power to raise revenue for such wages.[181]

The final requirement of *National League of Cities* is that no overriding federal interest be present. It appears that four Justices had a significant interest in mind, namely the war power.[182] Justice Blackmun, who concurred with the plurality, had a less significant interest in mind, specifically, environmental protection. Judging from Justice Blackmun's dissent in *Montana,* he views matters of energy crisis as very important[183] and would therefore vote against application of *National League of Cities.* The magnitude of the federal interest is also considered under a commerce clause analysis. As previously noted, the congressional record is devoid of any facts which indicate an important federal interest in suppression of severance taxes.

It appears, therefore, that in light of all the requirements

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177. *See H.R. Hearings, supra* note 107 (statement of Governor Herschler).

178. *Id. See also Taxation of Natural Resources, supra* note 15.

179. H.R. REPORT, SUPRA note 56, at 19.

180. 426 U.S. at 851.

181. Note that the power to tax must be affected directly by the federal action. The Court has rejected the contention that a statute's ultimate economic impact on states' taxing power falls within the protection of *National League of Cities. See* Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. at 277-80.

182. 426 U.S. at 871 n.18.

183. *See* 453 U.S. at 634.

of *National League of Cities,* a limitation on severance taxes "would impair the States' ability to function effectively in a federal system."[184] Whether there are enough votes for such a holding is doubtful.

The split between the conservative Justices in *Montana* gives the liberal wing the swing vote.[185] The liberals, including Justices Brennan and Marshall, may agree with the application of *National League of Cities,* knowing that with the demise of federally funded social programs under the "new"[186] federalism, increased state revenues will be needed. To summarize, it is likely that the Court, using *National League of Cities,* would invalidate a federal ceiling on state severance taxes.

C. *Equal Protection and "Free Market"*

Although this comment has focused on coal severance taxes imposed by western states, there are thirty-three other states imposing various other types of severance taxes. Most notably, some southern states such as Texas, which oppose the coal severance tax, collect $1.5 billion of oil and gas severance taxes annually.[187] The western states would naturally ask why they should sacrifice while states such as Texas collect high severance taxes.[188] The legal issue is whether a limitation on coal severance taxes violates the equal protection guarantee of the fifth amendment. Considered briefly, the answer is "no."

First, states are not a suspect class, nor is there any fundamental right to impose a severance tax higher than 12½ %.[189] In the absence of a suspect classification or a funda-

184. 426 U.S. at 852. *But see* Williams, *Severance Taxes and Federalism: The Role of the Supreme Court in Preserving a National Common Market For Energy Supplies,* 53 COLO. L. REV. 281, 312 (1982).

185. The dissenters in *Montana,* Justices Blackmun, Powell and Stevens, would uphold federal action regardless of *National League of Cities. See* 453 U.S. at 633. Similarly Justice White who concurred with the hope of federal action, may withhold his vote. *Id.* On the other hand, the pro-states' rights Justices, including Rehnquist, Burger and O'Connor, would favor the application of *National League of Cities.*

186. *See, e.g.,* Barnett, *Reagan's Bold New Blueprint,* U.S. NEWS & WORLD REPORT, Feb. 8, 1982, at 20; *State of the Union: "Seize These New Opportunities,"* U.S. NEWS & WORLD REPORT, Feb. 8, 1982, at 73; *The Reagan Gamble,* NEWSWEEK, Feb. 8, 1982, at 24.

187. *See Taxation of Natural Resources, supra* note 15, at 333.

188. *Id.*

189. *But see* text accompanying notes 141-157.

mental right, social and economic legislation are upheld if the legislative means is rationally related to a legitimate governmental purpose.[190] In short, the same rational relationship test required under the commerce clause is used. Under equal protection, however, there is a presumption of rationality that can only be overcome by a showing of arbitrariness and irrationality.[191] The statute's lack of uniform geographical impact, however, is not strong enough to overcome the presumption.[192] The only plausible argument is that a 12½% limit is arbitrary.

Even though an equal protection challenge does not offer a real alternative, the issues presented may have a significant impact upon the Court's policy consideration. Implicit in an equal protection challenge is the contention that the states in their taxing capacities operate in a free market system. Each state imposes taxes on its exported commodities. Of course, such taxes are eventually passed on to the consumers in other states. Therefore, the states pay each other based on their geographical or socio-economic advantages. For example, port states impose taxes on imports and industrial states impose retail taxes.[193] Accordingly, it may be argued that because resource-rich states and industrial states are mutually dependent, their respective taxes balance one another. Although this argument is an over-simplification, the Montana Supreme Court has indicated that export taxes is an economic fact of life.[194]

The Court's role in the states' "free market" system is set out in *Complete Auto* as modified by *Montana*. The Congress, also, acts to prevent undue interference in interstate commerce. But, in a free market setting, undue interference arises only when the states are not economically mutually dependent, so that a state can unilaterally increase its tax without any adverse consequences on its own economy. Therefore,

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190. *See* United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166 (1980).

191. *See* Duke Power Co. v. Carolina Environmental Study Group, 438 U.S. 59, 83 (1978).

192. *See* Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. at 288.

193. 453 U.S. at 641. (Blackmun, J., dissenting). The topic of State tax exportation involves complex economic considerations which are beyond the scope of this comment. For a detailed treatment, see Hellerstein, *Constitutional Limitations on State Tax Exportation*, 6 AM. B. FOUND. RESEARCH J. 1 (1982).

194. — Mont. at —, 615 P.2d at 857.

when states are economically dependent, they are under local political restraints. In fact, the guarantee of political restraint is a common thread running through the dormant commerce clause and the commerce clause limitations on state taxation of interstate commerce.[195] The substantial nexus requirement, like mutual dependence, ensures local political impact. Indeed, the state legislative bodies have witnessed the bulk of the severance tax controversies. Relying in part on political restraint, the Montana Supreme Court, in reaching its decision, took judicial notice of the fact that the opponents of severance taxes have been "a vigorous presence at any session of the Montana legislature."[196]

Viewed in another context, states have been free market participants when acting in proprietary capacities. In such a capacity, the Court has recognized that the states should only be restricted by market forces. For example, in *Reeves, Inc. v. Stake,*[197] the Court observed that "[t]here is no indication of a constitutional plan to limit the ability of the States themselves to operate freely in the free market."[198] In upholding North Dakota's right to sell cement only to in-state buyers, the Court relied in part on *National League of Cities,* noting that "state proprietary activities may be and often are, burdened with the same restrictions imposed on private market participants. Evenhandedness suggests that, when acting as proprietors, states should similarly share existing freedoms from federal restraints, including the inherent limits of the Commerce Clause."[199]

It is therefore sensible that when states, in their taxing capacity, face each other in the free market, they should only be restrained by the local impact of their taxes. In summary, as a policy matter, when states tax interstate commerce in compliance with the dormant commerce clause Congress should not interfere.

IV. Conclusion

A federal ceiling on state severance taxes is unconstitu-

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195. McGoldrick v. Berwind-White Co., 309 U.S. 33, 45 n.2 (1939).
196. — Mont. at —, 615 P.2d at 857.
197. 447 U.S. 429 (1980).
198. *Id.* at 437.
199. *Id.* at 439.

tional for several reasons. Firstly, there is no rational basis for concluding that severance taxes substantially affect commerce. In fact, the evidence indicates that severance taxes encourage conservation and afford the states the opportunity to diversify their economic bases, thereby benefiting the nation. Secondly, limiting states' taxes may be unconstitutional because it degrades the states' right or power to tax—a right which is beyond Congressional reach. Restricting the *manner* of state taxation, however, would evade this problem, but would leave the courts the difficult task of deciding the value of the state services to different taxpayers. Thirdly, regardless of the scheme used, a federal limit on state severance taxes is unconstitutional because it is an impermissible intrusion into states' sovereignty. Finally, even though restricting states' imposition of severance taxes may result in unequal treatment of the thirty-three states with severance taxes, such restriction will survive an equal protection challenge. Implicit in the equal protection issue, however, is the notion that states, in their taxing capacity, face one another in a "free market" which may be disrupted when the states are not economically mutually dependent. Economic dependence restrains the states because of its local political impact. The guarantee of political restraint, however, lies at the heart of the dormant commerce clause. As a matter of policy, therefore, it would be wiser for Congress not to interfere in the states' "free market" which is safeguarded by the dormant commerce clause.

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